CHASE

International Finance

Vol. XV, No. 8
April 14, 1980

Issued bi-weekly by the Economics Group of The Chase Manhattan Bank
for corporate customers and correspondent banks

B 1900-1
and 4/14/80

Behind the Volatility of the Canadian Dollar

The Canadian dollar has gyrated wildly on foreign-exchange markets in recent weeks, moving from US$.861 on February 15 to a high of US$.875 on March 3 and subsequently dropping to US$.834 on April 1. These fluctuations—both the ups and downs—came in the wake of the Liberal Party victory on February 18, making it difficult to ascribe either the credit or the blame to the new government. What, then, is the explanation for the Canadian dollar's erratic behavior?

In a recent *International Finance* article on the links between U.S. and Canadian policy, Chase economists contended that "any effort on the part of the Canadian (monetary) authorities to diverge permanently from an interest-rate policy followed by the United States would lead not to mild or gradual depreciation or appreciation, but rather to sharp movements in the Canadian currency's value", owing to the substitutability phenomenon.

Canadian/U.S. dollar exchange rate

This perhaps best explains the Canadian dollar's recent volatility. Immediately after the election, the first large divergence in U.S. and Canadian interest rates emerged while the Canadian dollar was strengthening by some 1.3 U.S. cents. The foreign-exchange markets apparently ignored the absence of interest-rate adjustment, assuming it would follow when the new Canadian Government was firmly in power. Market observers were focusing on the good news out of Canada; i.e., that a majority government had been elected, trade appeared to be improving, and more discoveries of oil and gas were being made. This news boosted the Canadian dollar to highs not seen for 10 months. But then participants began to wonder about the Bank of Canada's commitment to maintaining a monetary policy similar to that of the United States. Once the markets began asking this question, the Canadian dollar began to sink. And once the markets came to believe in the real possibility of longer-run divergence between U.S. and Canadian monetary policy, the Canadian currency began to slide.

More recently, the Canadian dollar has stabilized somewhat. The major reason is the Bank of Canada's decision to allow the discount rate to float with the Treasury bill rate (and the implication that upward interest-rate movements would be politically palatable), as well as central bank intervention.

All in all, the experience with the Canadian dollar demonstrates that, as pointed out in the earlier *International Finance* article, "the (foreign-exchange) markets serve as a stern taskmaster, demanding in the long run that Canadian and U.S. policymakers follow similar paths, but forgiving short-run divergences." The short run now appears to be over.

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New U.K. budget underscores commitment to less government.

The new U.K. budget, unveiled on March 26, reveals the Thatcher Government's resolve to hold firmly to a policy of reducing the public-sector role and encouraging private enterprise. The Government plans a steady reduction in its expenditures, its budget deficit, and hence, in the rate of monetary growth, in the hopes of containing inflation. The authorities have also announced plans to treat social security benefits as taxable income and to reduce benefits payable to families of striking workers. Although the long-run impact of these policies may prove beneficial, the economy will encounter difficulties in the short run. The increased taxes on cigarettes and alcohol, for example, are expected to boost the rate of inflation, now 19.1%, to over 20% in the next few months. And tight money policies mean that there will be little opportunity in the near term to reduce interest rates from their current record levels. This in turn will work to dampen investment and add to strengthening recessionary forces, which already threaten the economy with a 2% GNP decline for 1980. Moreover, despite weakening activity, import demand is expected to continue strong, and the balance of payments is expected to remain in deficit to the tune of £200 million per month, despite increasing North Sea oil production.

Austrian interest rates raised to protect the schilling.

The Austrian monetary authorities have boosted the central bank discount and Lombard rates to their highest levels in 25 years—6.75% and 7.25%, respectively. The recent rate hikes—the second so far this year—were prompted by the need to protect the Austrian schilling, which is tied to the German mark, in the face of rising German interest rates and a widening current-account deficit. The current-account payments gap is forecast to rise from $2 billion in 1979 to more than $2.5 billion this year, the result of more costly oil imports. The country's net external borrowing is thus expected to climb from $870 million in 1979 to about $1.4 billion this year. Although debt service payments are estimated at some $500 million in 1980, annual exports of about $15 billion should keep the debt-service ratio comfortably low.

Greek austerity measures may cut real GNP growth sharply in 1980.

After four years of rapid growth, the Greek economy began overheating last year, just as oil prices were boosted. Real economic growth is provisionally estimated at 3.9% in 1979, and the rise in consumer prices averaged 19%, compared with consumer price inflation of 12.5% in 1978. The current-account deficit is estimated to have widened to about $2.3 billion after a $1.2-billion shortfall in 1978. Responding to these imbalances, the authorities took corrective actions in late 1979. Interest rates were raised, public spending plans were scaled back, a six-month 75% deposit scheme for non-essential imports was introduced, and an incomes policy aimed at holding wage increases to below 18% was imposed. While these measures should deflate the domestic economy, driving real economic growth to as low as 1.5%, another spurt in the net oil bill will probably help widen the current-account gap to about $2.5 billion in 1980. Inflation, however, should begin to ease late this year, and if present policies are maintained, the current-account deficit could improve in 1981. In the interim, Greece is expected to be a significant borrower on the international capital markets.

Korean economy adjusts to slower growth.

Korea's economy has entered a new adjustment period, shifting from a very rapid pace of expansion and accelerating inflation to a more steady growth path. Real GNP growth dropped to 7.1% in 1979 from an average of 11.7% in the three years preceding. The rate of inflation, however, worsened. Consumer prices increased by 21% in 1979, compared with 16.4% in the previous year. And in the external sector, the current-account deficit reached $3.9 billion, well above the $1.1-billion gap posted in 1978. This year, economic growth is expected to decelerate further to between 3% and 5%, while the current-account deficit may approach $5 billion. The inflation rate will likely remain over 20%, although the Government has taken steps to curb it. Fiscal and monetary restraints have been adopted, and the effects of high inflation will be moderated through flexible management of exchange and interest rates, (i.e., allowing the won's exchange value to decline and interest rates to rise). It is hoped that such policies will correct the distortions in the economy over time.

Brazilian authorities committed to price stabilization.

Brazilian inflation crept up to an annualized pace of 83.8% in March 1980, compared with a rate of 77% prevailing at the end of 1979. The upward price movement in the first quarter of 1980 was not unexpected, however. Farm support prices were raised in the hopes of stimulating output, while Brazil has had to absorb sharply higher oil import costs. The higher inflation levels have prompted the Government to underscore its commitment to utilizing a wide variety of price-stabilization policies. Most notably, the rate of credit creation is being held below the rate of price increase. And on the fiscal-policy front, public expenditures are being closely monitored and controlled. These efforts to restrain aggregate demand will have more impact on real economic growth than inflation, however, unless the rate of increase of wages can be brought under control.

UAE surplus rising steadily and dramatically.

The United Arab Emirates, an OPEC member that accounted for 5.9% of total OPEC crude oil output last year, registered a surplus on current account of an estimated $6½ billion in 1979, versus an estimated $2¼ billion in 1978. This growth reflects the marked increase last year in the price of oil exported by the largest of the seven sheikdoms that comprise the federation, Abu Dhabi and Dubai. The official sales price of UAE oil rose 50% to a weighted average of $19.67 per barrel, bringing in estimated net oil revenues of about $12¼ billion. At the same time, imports of goods and net services, as well as transfer payments, rose to an estimated $7¾ billion. But non-oil earnings of an additional $2 billion, consisting mainly of income from foreign assets, brought the overall UAE surplus to $6½ billion. The UAE's 1980 current-account surplus is expected to be markedly higher. Official prices in 1980 will probably average at least $30 per barrel, generating net oil revenues of nearly $18¾ billion. And even allowing for a 24% increase in current-account outflows to $9¾ billion, the resulting surplus is projected to be $12 billion, nearly double that of 1979.

Copper pricing back to supply and demand fundamentals.

Against the background of a U.S. slowdown and the increased likelihood of economic weakness in Europe and Japan, sharply rising interest rates and a collapse of precious metals prices have apparently wrung the speculative excesses out of the copper market. Since the first quarter of 1979, when copper supply was restricted by strikes in Canada and production and shipping problems in Zambia and Zaire, the supply/demand balance has been improving gradually; in fact, supply shortfalls disappeared well before year-end. As of February 1, 1980, for example, U.S. inventories were about 12% higher than in October 1979. U.S. producer prices of copper had risen from 80¢-90¢ per pound last June to a high of around $1.45 in mid-February, coinciding with the sharp run-up in inflation and precious metals prices. They are now back in the 90¢ range. Prices will likely remain weak over the next twelve months as worldwide copper demand continues to slacken. Since contracts for U.S. copper workers are set to expire on June 30, however, near-term prices could recover temporarily if a strike threat becomes more real or if international political tensions worsen.

Commodities Lose Their Speculative Appeal

For all the turmoil they have experienced in recent months, the commodity markets may finally be signaling a bit of good news from the price front. Since mid-February, prices of a wide range of commodities have fallen dramatically. Over previous business cycles, commodity price shifts have often foreshadowed movements in the general price level. And now that prices of a number of commodities have been falling for two months, some economists are expressing cautious optimism that the frantic commodity speculation with which the year began has calmed down, and that inflationary expectations have, at least to some extent, eased.

Whether this will actually prove to be the case remains to be seen. It is difficult to generalize about a diverse group of markets subject to as many different influences as the commodity markets. One thing, however, seems certain: virtually all commodities—from pork bellies to platinum—have been affected by recent record-high interest rates. Clearly, high rates have significantly dampened speculative demand by making it more expensive to hold inventories and finance futures contracts. In addition, investors who had turned to the commodity markets in search of an inflation hedge can now find other less risky investments.

All these influences have contributed to downward price pressure in commodity markets. Commodity prices are now also reflecting the general slowing of the U.S. economy. Lumber and plywood prices, for example, have fallen 4½% since last fall as a result of the cutback in construction activity. Nonetheless, many commodity prices still remain above their year-ago levels. Precious metals prices, for instance, have eased substantially in recent weeks, but are still well above where they stood this time last year. And the same holds for some of the agricultural commodities, such as sugar, cotton, and wheat. The full impact on commodity prices of a possible U.S. economic slowdown coinciding with one in Europe and Japan is yet to be felt.

Many economists are doubtful about how much of that impact will actually be reflected in the key indexes of inflation. There are many other costs—energy, labor, and transportation, for example—that factor into the final prices of goods at later stages of production and distribution. Continued increases in the prices of these elements may well offset price declines in the commodity markets. However, if a global recession develops, sharply reduced worldwide demand for commodities may help ease overall inflationary pressures in the U.S. economy by precipitating further steep declines in commodity prices.

Asia and Oceania — Bimonthly Survey of Business and Finance

	COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GNP IN 1979*		BALANCE			
			3 months ending	change from year earlier	in billions of dollars	per capita	latest data	reserves (less gold) in million $	12-month change	months of imports covered
Asia	Bangladesh	Real growth rose only 4% in 1979, owing to a disappointing agricultural performance.	June	+ 24%	8.9	$ 103	Feb.	449	+ 32%	3.6
	Burma	Four industrial nations grant $70 million in aid to modernize fishing industry.	Nov.	+105%	4.3	128	Jan.	212	+ 82%	7.6
	China, People's Republic	Grain output increased by 3.4% in 1979.	Oct.	+ 81%	515.0	510	June	3,538	+ 11%	3.0
	Hong Kong	Real economic growth expected to slow to 9% in 1980 from 11.5% in 1979.	Jan.	+ 37%	16.6	3,320	n.a.	—	—	—
	India	Sugar output for 1980/81 estimated at 7 million tons, compared with 4 million tons in 1979/80.	Dec.	− 3%	121.1	188	Dec.	7,432	+ 15%	9.9
	Indonesia	Real growth rate forecast to reach 7.5% in 1980/81, versus 5% last year.	June	+ 20%	43.4	289	Jan.	4,712	+ 57%	8.7
	Japan	Oil consumption in 1979 dropped 5% from previous year's level.	Feb.	+ 27%	948.0	8,243	Feb.	20,000	− 38%	2.2
	Korea	Manufacturing sector expanded 10.2% in 1979, versus 20% in 1978.	Jan.	+ 23%	61.1	1,624	Jan.	2,796	+ 2%	1.8
	Malaysia	Government plans substantial increase in public investment this year.	Sept.	+ 52%	17.3	1,310	Dec.	3,915	+ 21%	6.8
	Pakistan	Cotton output for 1979/80 estimated to reach 4.2 million bales, up 45% from 1978/79.	Nov.	+ 59%	20.9	265	Jan.	209	− 52%	0.6
	Philippines	Government projects 6% real GNP growth for 1980.	Jan.	+ 44%	29.1	512	Jan.	2,274	+ 30%	4.2
	Singapore	Industrial production climbed an annualized 11% in fourth-quarter 1979.	Dec.	+ 44%	8.9	3,708	Nov.	5,688	+ 10%	3.9
	Sri Lanka	Government plans to abolish all subsidies on consumer goods this year.	Oct.	+ 23%	3.1	206	Dec.	517	+ 30%	4.1
	Taiwan	Gross domestic capital formation increased 21.9% in 1979.	Feb.	+ 36%	27.6	1,623	Feb.	1,546	+ 7%	1.2
	Thailand	Rice production declines slightly to 17 million tons in 1979/80.	Nov.	+ 25%	26.0	565	Jan.	1,964	− 11%	3.4
Oceania	Australia	Government's large deficit declined slightly in first-half FY 1979/80.	Jan.	+ 38%	124.0	8,551	Jan.	1,711	− 17%	1.1
	New Zealand	Wool production will reach a record level of 343,000 tons this year.	Feb.	+ 33%	15.4	4,812	Jan.	464	− 26%	1.6
	Fiji	Real GDP growth estimated at 3% in 1979.	Sept.	+ 34%	0.9	145	Feb.	169	+ 28%	5.1

Loan Commitments Up Sharply

New figures reveal a substantial expansion of bank loan commitments in February. According to data just released by the Federal Reserve, commitments extended by the larger banks to nonfinancial business firms rose $9 billion in February, to a total volume of over $324 billion. This was the largest single monthly advance in the five years this data series has been maintained. And the rapid pace probably carried into March. From September through February, the total rise of commitments approximated a whopping $34 billion. These increases were mainly additions to unused commitments, rather than actual drawdowns of funds under commitments.

The surge in commitments has reflected a number of financing developments. First, overall funding requirements have expanded significantly in recent quarters—a typical pattern in the latter stages of a business cycle. Second, more recently the bond market's receptiveness to new debt offerings has eroded materially. Consequently, many firms have had to change their financing strategies. In this process, there has been substantial reliance on bank loans and commercial paper. Loan commitments from banks have been an adjunct to this financing strategy. Finally, a considerable amount of new commitment activity undoubtedly reflected concern by businesses over their future access to bank financing in the event of a government program of explicit credit curtailment.

The question that probably cannot be answered for some months (perhaps quarters) to come is how much recourse there will be to the higher volume of commitments. In recent years this usage factor (i.e., outstanding loans made under commitments as a percentage of the sum of such loans plus unused commitments) has ranged from a low somewhat above 37% (about where it is now) to a high of 46% in early 1975. Between 1976 and 1979, usage typically ranged between 38% and 39%. On average, in the months before the rapid commitment growth that began in late 1979, usage was running around 39%. Applied to the new February figures, such usage would raise actual loans outstanding by around $5 billion, or 4½%. Applying the unusually high usage of early 1975 would add $28 billion in loans outstanding.

While this arithmetic exercise could obviously be carried to even greater extremes, at least two major points seem clear. First, within a plausible range of usage percentages, drawdowns under existing commitments could increase outstanding loans by a sizeable amount. And such a pattern could develop within a relatively short time period—e.g., a few months. Second, such a spurt would entail heavy bank funding pressures in the money markets. Against this background, the emergence of signs of developing recession will by no means signal imminent relief from possible financing problems in the business sector.

PAYMENTS		MONEY AND BANKING							COUNTRIES
		12-month changes				central bank rate	exchange rate in U.S. dollars		
of IMF t, mil- dollars	current influences on payments	latest data	consumer prices	latest data	domestic credit	April 9, 1980		current monetary conditions	
22	Exports expected to rise 16% in FY 1979/80 to $700 million.	Dec.	+18%	Nov.	+20%	—	.0675	Credit restrictions remain in force.	Bangladesh
71	Rice export earnings rose 73% in 1979.	Dec.	+ 8%	n.a.	—	—	.1550	Improved reserves position boosts money supply growth.	Burma
0	U.S.-China trade nearly doubled in 1979.	n.a.	—	—	—	—	.6800	Bank of China borrows $300 million in Eurodollar market.	China, People's Republic
—	January trade deficit widened sharply, owing to export slump.	Jan.	+16%	Jan.	+37%	—	.1990	Prime rate reached 16% in March.	Hong Kong
0	Energy import bill will climb 30% to $6.25 billion in FY 1980/81.	Dec.	+12%	Nov.	+20%	9.00%	.1240	Large budget deficit boosts money supply growth.	India
0	Japan extends $1-billion loan for energy development.	Jan.	+28%	Oct.	+40%	—	.001635	Bank loans slowed in January.	Indonesia
0	Auto exports to U.S. rose 34% in February from year-earlier level.	Jan.	+ 7%	Dec.	+ 8%	9.00%	.003972	Government lifts restrictions on Eurodollar lending.	Japan
37	Textile export target for 1980 set at $4.9 billion.	Jan.	+24%	Jan.	+41%	15.00%	.0018	Tight monetary policy continues.	Korea
0	Export growth for 1980 projected at 23%.	Jan.	+ 6%	Dec.	+ 6%	—	.4380	Government restricts bankers' acceptance market.	Malaysia
36	Current-account deficit could reach $1.4 billion in FY 1979/80.	Jan.	+10%	Nov.	+24%	10.00%	.1020	Tight credit conditions persist.	Pakistan
67	Premium export tax to be imposed on precious metals exports.	Dec.	+24%	Dec.	+27%	4.00%	.1365	Central bank to liberalize domestic banking laws.	Philippines
0	January trade deficit was 45% larger than January 1979.	Jan.	+ 8%	Oct.	+24%	—	.4420	Prime rate climbed to 12% in March.	Singapore
08	Import and excise duties raised on certain consumer goods.	Nov.	+15%	Nov.	+42%	10.00%	.0675	Large budget deficit fuels money supply growth.	Sri Lanka
0	Exports in January-February rose 36% above year-earlier period.	Feb.	+18%	Jan.	+15%	14.00%	.0290	European banks now permitted to conduct business.	Taiwan
39	Rice export volume will drop 40% this year.	Dec.	+15%	Oct.	+23%	12.50%	.0510	Credit conditions remain restrictive.	Thailand
75	Wheat and flour exports continue to expand rapidly.	Dec.	+10%	Dec.	+15%	—	1.0850	Interest rates rise in response to those overseas.	Australia
56	Current-account gap nearly doubled in 1979.	Dec.	+17%	Dec.	+15%	13.00%	.9425	Loan advances rose 21.4% in January.	New Zealand
5	Higher sugar prices will boost export earnings this year.	Jan.	+10%	Jan.	+24%	—	1.19	Domestic credit grew 30% in 1979.	Fiji

World Interest Rates

market rates of April 9, 1980; bond yields as of April 4, 1980

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	13.00 large banks 16.00	16.20	17.00*	14.00	9.50	7.00	15.00 penalty rate 18.00	9.50	3.00	9.00
Day-to-Day Money	19.25 April 10	16.00	17.25*	14.15	12.25	9.25	17.00	10.75	15.00	12.1875
Treasury Bills 91-day, Middle Rates	14.37	15.95	16.25*	17.50	n. a.	n. a.	14.60 82-day	no dealing	no market	5.625 2-month
Commercial Paper prime, 3-month, asked	15.00 finance paper	16.875 finance paper 15% tax w/h	15.95*	13.90 Certified	13.00 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	16.95	16.75 15% tax w/h	17.625*	15.25 Certified	not traded	9.40	19.80	no market	4.50 not traded	no market
Government Bonds Long-term, new and old issues, average yield	12.13	13.75	14.30	11.70 20% tax w/h	13.44	9.84*	14.87	11.10	5.11	9.96
Industrial Bonds prime, long-term, new and old issues, average yield	13.65 Aa Industrials	14.50	14.99	16.84	14.80	9.98*	14.83	12.39	6.04	7.56
Bank Short-Term Rate to Best Borrowers (prime rate)	20.00	17.50	18.50*	18.75	14.85	10.75	20.00	13.50	5.00	9.25
Bank Time Deposits 3-month	17.375 Cert. of Dep.	16.75 Cert. of Dep.	18.4375*	17.70	13.25	10.15	10.75	11.125 large deposits	6.75 residents only	5.00 20% tax w/h
Eurocurrencies 3-month, asked	19.3125	no market	18.25	no market	13.4375	9.9375	no market	11.1875	6.9375	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8462	2.1800	.032970	.2290	.5302	.001138	.4833	.5610	.003972
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	2.375 *P*	.375 *P*	1.875 *P*	5.50 *P*	9.00 *P*	.625 *P*	7.875 *P*	12.25 *P*	4.875 *P*

Eurodollar Deposits
(London, interbank, bid)
April 10

7-day	18.375
1-month	18.75
3-month	18.8125
6-month	18.25

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	n. a.
U.S.-Canada Treasury Bills	−3.14
U.S.-Canada Finance Co. Paper	−4.02
Eurodollars-U.K. Local Auth. Deposits	n. a.

Eurobonds
(average yield on recent straight debt issues)

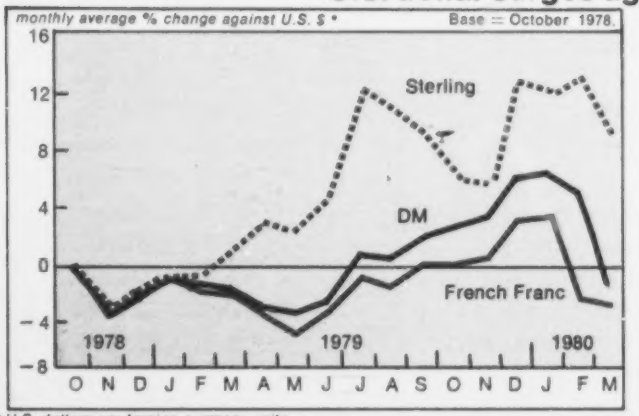
U.S. Dollar Bonds	
7 yrs. and under	13.75
Over 7 yrs.	14.125
DM Bonds	
7 yrs. and under	10.00
Over 7 yrs.	10.00

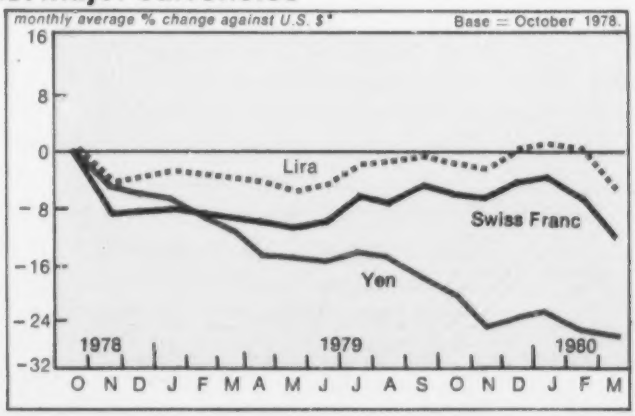
Gold Price
London afternoon fixing
554.00
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.

* Rates as of April 2; bond yields as of March 28.

U.S. dollar surges against major currencies





* U.S. dollars per foreign currency units

Hard Times for the Eximbank

The U.S. Export-Import Bank has come far in its effort to boost American exporters' competitive position in world markets with more attractive financing. But it is now faced with serious constraints that threaten its new style of aggressiveness—an aggressiveness that some bank critics claim is unwarranted and unsound.

The Export-Import Bank is the sole U.S. Government agency mandated to support U.S. exports through direct financing and guarantees. It has historically lagged behind its European and Japanese counterparts in the degree and scope of financing support offered because, unlike its main competitors, it must operate on a self-sustaining basis. But since 1977, the bank has been far more aggressive in meeting foreign competition by cutting interest rates, financing a greater share of export transactions (in partnership with private banks), and offering new forms of support. Specific initiatives have included:

- maintaining the low interest-rate scale and cutting rates still further below scale to match competition in specific cases. The Eximbank's interest rates are on a sliding-scale basis, ranging from 7.75%-8.75%, depending upon maturity. The scale has not been raised, despite the sharp uptrend in both U.S. money market rates and Eximbank borrowing costs.

By January 1980, Eximbank-supported financing had clearly become more competitive, as the following table shows:

Approximate Interest Cost of Officially-Supported Long-Term Export Credits*

(percent per annum)

United States	9.50 (8.50)[1]
Canada	9.70
France	8.55
Germany	8.50
Italy	9.36
Japan	8.00
United Kingdom	8.55

*Includes fees, insurance, and private financing where required.

[1] For important transactions where competition is intense, Eximbank finance covers the entire credit.

In fiscal 1979 (ended September 30, 1979) about 40% of the value of all Eximbank direct credit authorizations carried below-scale rates. The average interest rate on new Eximbank direct credits in fiscal 1979 was approximately 8.2%, even though the average cost of funds to the bank had risen to 9.3% by the fourth quarter. The average interest rate on recent authorizations is currently between 8.2% and 8.3%, while the average cost of funds is now 10.7%, and the marginal cost, over 13%.

- increasing the bank's direct loan participation to as high as 85% of contract values in many instances. In fiscal 1979, 30% of total Eximbank direct credit authorizations were for transactions where the Eximbank's financing share of individual contract values was 85%. The prime motivation behind the bank's increased share has been to reduce the blended interest rate by minimizing the role of much-higher-cost commercial bank finance.
- extension of general purpose lines of credit. Last fiscal year, the Eximbank authorized lines in support of $714 million in exports.
- local cost financing. The bank has the option to finance foreign local costs associated with the export of U.S. capital equipment and industrial plants that it is financing.
- guarantees of foreign-currency-denominated loans made by commercial banks. The purpose of this new protection is to provide an alternative to dollar-denominated credits; foreign-currency credits may be perceived as more competitive in periods of U.S. dollar strength.
- responding to foreign "mixed credit" offers. Eximbank has matched, on a number of occasions, the foreign practice of blending official export credits with aid to arrive at low-cost, long-term financing.
- authorization to finance domestic sales. If American firms are offered foreign products on credit terms that violate the minimum standards set in the international arrangement on export credits, the Eximbank may help finance U.S. imports.
- liberalization of insurance and guarantee protection, including increased political risk coverage, and certain insurance fee reductions.

In addition to these policy initiatives, the Eximbank's overall level of activity has increased dramatically. Direct credit authorizations—the key indicator of support for major, high-impact exports—totaled $3.7 billion in fiscal 1979, compared with $2.9 billion the year earlier and only $700 million in fiscal 1977. Total authorizations for *all* bank programs (including financing and guarantees) were $9.5 billion in fiscal 1979, up 29% from the $7.4 billion of fiscal 1978. Total bank authorizations in 1978 were, in turn, 32% higher than in 1977. In the first quarter of fiscal 1980 (October-December 1979), direct credit authorizations totaled over $1 billion, up 120% from first-quarter 1979, while authorizations for all bank programs were up 55% over the year-earlier quarter.

More recently, however, the Eximbank has encountered severe constraints on its expansive posture. The most onerous problem facing the Eximbank at the present time concerns its direct lending authority—for both fiscal years 1980 and 1981. The bank initially

Hard Times for the Eximbank *(continued from page 7)*

requested a ceiling of $4.1 billion for fiscal 1980. But Congress has failed to approve the request, effectively holding fiscal 1980 direct loan authorizations to their fiscal 1979 level of $3.75 billion—a sharp decline in real terms. And in February, a Senate subcommittee rejected the bank's proposed direct lending budget of $4.4 billion for fiscal 1981, demanding a more complete accounting of the bank's expenditure plans. It now appears that the ceiling for fiscal 1981 will lie somewhere between $4.1 and $4.3 billion. Such retrenching in the direct lending area has alarmed Eximbank officials who contend that cuts in this area have the potential for the most serious repercussions on the U.S. export performance, since this program supports the most exports per authorizations dollar.

As for the remainder of fiscal 1980 (ending September 30), the Eximbank's direct lending authority will have to be curtailed sharply. It is estimated that less than $500 million in loan authorization funds now remain. This may force the bank to close its lending window by late spring, unless the $3.75-billion lending limit is boosted before then. The likelihood of a budget crunch, however, has prompted the bank to adopt tighter direct lending guidelines. The Eximbank will generally offer interest rates of not less than 8.75%; it will attempt to limit its financing share of individual transactions to 65%; and it will restrict the volume and tighten the terms on aircraft loans (which accounted for 38% of all Eximbank direct loans in fiscal 1979).

As an inducement to U.S. exporters to participate in financing, however, the Eximbank is prepared to increase its financing share of individual deals by up to 10% if exporters will finance matching shares at the same 8.75%. (The goal is full 85% financing at the subsidized rate.) This appeal to the export community is reminiscent of a similar Eximbank appeal to commercial banks in early 1978 to provide fixed-rate export financing with Eximbank guarantees of a market rate of return. The latter proposal failed to generate much interest, but Eximbank officials appear more optimistic about exporters' willingness to respond to the bank's latest initiative.

Other limitations preventing the bank from providing flexible and competitive support include:

- time-consuming oversight by the Departments of Commerce, State, and Treasury, the Federal Reserve, and the Office of Management and Budget. Congress also influences Eximbank activity by setting annual authorization limits, and having the right of approval on transactions valued at over $100 million;
- human rights limitations that prohibit Eximbank from financing exports to such countries as Chile; and
- inability to boost worldwide interest-rate minimums specified in the international arrangement on export credits; these currently range from 7.5%-8.0%. Increasing these rates is especially critical in view of the bank's high cost of funds, but progress in negotiations remains elusive.

The relative importance of financing

It is difficult to say how all these limits and constraints will hurt the competitive position of U.S. exporters, since financing is only one aspect of export competitiveness. Other important influences include the wide range of government tax and legal restrictions that can inhibit U.S. businesses from competing abroad effectively. Responsibility also lies in the private sector; U.S. exporters must aggressively pursue export opportunities, with products that are competitive in terms of price, quality, and suitability to foreign tastes.

Moreover, an important justification for increased export competitiveness is to improve the U.S. trade balance. But in this regard, opponents of the Eximbank, and of export subsidization in general, argue that curbing imports is equally effective. And this can be accomplished by reducing domestic demand with less expansive fiscal and monetary policies, which could also help ease inflationary pressures. Opponents of an increased Eximbank role also argue that Eximbank funds are wasted on financing the exports of large corporations that do not really need the financial subsidy, while others worry about the effect of expanded and generous support on the bank's long-term financial condition.

Nevertheless, with heightened concern about employment and recession in various sectors of the economy—evidenced by the increased pressure for protectionism—U.S. exporters are making a strong case for the stimulus provided to exports, and to the economy, by increased Eximbank support. And perhaps in the short run, there is good justification for both greater operational autonomy and increased Eximbank funding (applied to a diversity of industries and markets)—if only to keep pace with our competitors abroad.

But U.S. Government and business leaders are realizing that a more comprehensive approach to the overall issue of U.S. competitiveness is needed for the long run. This must consist of a coordinated effort by both public and private sectors to foster increased productivity and competitiveness through a combination of tax and legal incentives for exporters and private bankers, stepped up research and development, competitive pricing, and aggressive marketing. To the extent that progress is made in these areas, the Eximbank's role could be reduced over time.

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